INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute involved	2
Statement	3
Reasons for granting the writ	8
Conclusion	16
Appendix A	17
Appendix B	24
Appendix C	25

CITATIONS

Cases:

Brown Shoe Co. v. *United States*, 370 U.S. 294	12
California Packing Co., 25 F.T.C. 379	11
Federal Trade Commission v. *Morton Salt Co.*, 334 U.S. 37	11, 15, 16
International Salt Co. v. *United States*, 332 U.S. 392	11
Mechanical Mfg. Co., 16 F.T.C. 67	11
Northern Pacific R. Co. v. *United States*, 356 U.S. 1	11
Standard Oil Co. v. *United States*, 337 U.S. 293	13
United States v. *Aluminum Co. of America*, 377 U.S. 271	12
United States v. *General Dynamics Corp.*, Civ. No. 62–3686, S.D.N.Y., Nov. 8, 1962	8
United States v. *General Motors Corporation*, 61 Cr. 340 N.D. Ill., April 12, 1961	8

Cases—Continued

	Page
United States v. *General Motors Corporation*, 63–C–80, N.D. Ill., Jan. 14, 1963	8
United States v. *Philadelphia National Bank*, 374 U.S. 321	12
Waugh Equipment Co., 15 F.T.C. 232	11

Statutes:

Clayton Act, Section 7, 38 Stat. 731, as amended, 15 U.S.C. 18	2, 3, 5, 8, 11, 16

Miscellaneous:

Ammer, *Realistic Reciprocity*, Harv. Bus. Rev., Jan.-Feb. 1962	8
Back Scratching Deals Raise Antitrust Ire, Business Week, Feb. 9, 1963	9
Donnem, *Conglomerate Mergers and Reciprocity*, 8 Antitrust Bull. 283	8
Edwards, *Conglomerate Bigness as a Source of Power*, in Business Concentration and Price Policy 331	9
32 Geo. Wash. L. Rev. 832	8
Handler, *Emerging Antitrust Issues: Reciprocity, Diversification and Joint Ventures*, 49 Va. L. Rev. 433	8
Hausman, *Reciprocal Dealing and the Antitrust Law*, 77 Harv. L. Rev. 873	8
Reciprocity, A Dilemma for Purchasing Agents, Electrical World, Sept. 24, 1962	9
Reciprocity Smirks Behind the Sales Smile, Chemical Week, Nov. 22, 1958	9
Stocking and Mueller, *Business Reciprocity and the Size of Firms*, 30 J. of Bus. of the Univ. of Chi. 73	9
Teeple, *The P.A, Faces Reciprocity*, Purchasing, Jan. 1955, p. 81	9
49 Va. L. Rev. 852	8
Wall Street Journal, Dec. 4, 1963	9
72 Yale L. J. 1265	8

In the Supreme Court of the United States

OCTOBER TERM, 1964

No. ——

FEDERAL TRADE COMMISSION, PETITIONER

v.

CONSOLIDATED FOODS CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the Federal Trade Commission, petitions for a writ of certiorari to review the judgment of the Court of Appeals for the Seventh Circuit entered in the above cause on March 24, 1964.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*, pp. 17–23) is reported at 329 F. 2d 623. The opinion of the Federal Trade Commission (App. C, *infra*, pp. 25–52; J.A. 52–78)[1] is not yet officially reported. The initial decision and order of the hearing examiner are reproduced at J.A. 30–50.

[1] "J.A." refers to the printed joint appendix filed in the court of appeals.

JURISDICTION

The judgment of the court of appeals was entered on March 24, 1964 (App. B, *infra*, p. 24). On June 20, 1964, Mr. Justice Clark extended the time for filing a petition for a writ of certiorari to July 22, 1964, and on July 21, 1964, Mr. Justice Stewart granted a further extension to August 21, 1964. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether a large wholesale and retail grocer's acquisition of the assets of a firm producing ingredients used by processors of food who supply the grocer, violates Section 7 of the Clayton Act because such a merger creates a substantial probability that reciprocal buying policies will foreclose a substantial part of the already highly concentrated market for the ingredients to the competitors of the acquired company.

STATUTE INVOLVED

Section 7 of the Clayton Act, 38 Stat. 731, as amended, 15 U.S.C. 18, provides in pertinent part:

> That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be

substantially to lessen competition, or to tend to create a monopoly.[2]

STATEMENT

The Federal Trade Commission held that the acquisition in 1951 by Consolidated Foods Corporation ("Consolidated") of Gentry, Inc. ("Gentry") violated Section 7 of the Clayton Act because it injected an anticompetitive influence into an already highly concentrated market. The Commission found a real danger that through "reciprocal buying" competitors will be foreclosed from a substantial share of the market for the products—dehydrated onion and garlic—sold by Gentry. The Seventh Circuit reversed, holding that the failure of Gentry to increase its share of the market in the years following the merger, even though Consolidated had attempted to induce reciprocal buying, demonstrated that the merger had no substantial anticompetitive effect.

1. The facts are as follows:[3]

Consolidated is a large, diversified food company which owns several food processing plants and a nationwide network of wholesale and retail food stores (J.A. 53). In 1956 it had net sales of more than $268 million and assets of $99 million—an increase in each of about 50 percent since 1951 (J.A. 53). Consoli-

[2] There is no dispute about threshold issues. It was agreed that the relevant "section of the country" was the whole United States, and that dehydrated onion and dehydrated garlic constituted the appropriate "lines of commerce" (J.A. 67 n. 5). Both parties below and the court of appeals, in appraising the effects of the merger, treated dehydrated onion and garlic as a single line of commerce, rather than as separate lines, and we continue to do so in this Court.

[3] The statement of facts is taken primarily from the Commission's findings, none of which was overturned by the court below.

dated is a substantial purchaser of the products of food processors (over $134 million in 1955) (J.A. 1973–1974). The processors, in turn, purchase dehydrated onion and garlic for use in packing their foods (J.A. 56).

Gentry is a firm principally engaged in the manufacture of dehydrated onion and garlic, with assets at the time of acquisition of $1.6 million (J.A. 53–54). In 1950, immediately prior to its acquisition by respondent, Gentry accounted for about 32 percent of the total sales of the dehydrated garlic and onion industry, and together with its principal competitor, Basic Vegetable Products, Inc. ("Basic"), accounted for almost 90 percent of total industry sales.[4] The remaining 10 percent was divided between two firms.[5] By 1958 the total industry output of both products had more than doubled; Gentry's share had risen slightly to 35 percent; and the combined share of Gentry and Basic remained at 90 percent.[6]

[4] Gentry accounted for 28 percent of the industry's sales (by weight) of dehydrated onion and 51 percent of garlic; Basic sold 60 percent and 36 percent, respectively (J.A. 54).

[5] At the time of the acquisition the onion and garlic industry contained 4 firms: Gentry, Basic, and the relatively tiny Puccinelli Packing Company ("Puccinelli") and J.R. Simplot Company (J.A. 34, 35, 54). The latter concern left the industry in 1956; in 1959 Gilroy Foods, Inc., entered the market and, in 1961, it was purchased by McCormick Foods, Inc., whose requirements exceed Gilroy's total output (J.A. 34, 73 n. 9).

[6] The market share figures in onion were: Gentry, 35 percent, Basic, 57 percent; in garlic they were: Gentry, 39 percent, Basic, 50 percent. Thus, following the merger, Gentry increased its share of the onion market by 7 percentage points (or 25 percent); and its share of the garlic market declined by 12 percentage points (or about 24 percent). The rise in its

2. The Commission held that respondent's acquisition of Gentry violated Section 7 because it gave respondent a new and essentially anticompetitive advantage—the mixed threat and lure of reciprocal buying—which was not available to its competitors, and which promised further to rigidify an already concentrated industry and to discourage new entry.

Reciprocal buying occurs where Company *A* is induced or influenced to purchase a product sold by Company *B* by its desire to retain or obtain Company *B* as a customer for its own products. Reciprocal buying, in the words of the Commission, "involves nothing more than the simple idea that 'I will buy from you if you will buy from me,' or the unspoken 'If I buy from him, he will buy from me' " (J.A. 56). Since Consolidated, as a result of its acquisition of Gentry, is a seller of dehydrated garlic and onion and at the same time a purchaser from food processors who are buyers of dehydrated garlic and onion, processors desiring to retain or obtain Consolidated's patronage as a customer for their products are, the Commission found, likely to give preference to Consolidated as a source of supply of their dehydrated garlic and onion requirements.

The Commission pointed out that business reciprocity is necessarily anticompetitive (J.A. 62):

> * * * It distorts the focus of the trader by interposing between him and the traditional competitive factors of price, quality, and serv-

share of the combined market is accounted for by the fact that in 1958 the industry sold about 3½ times more dehydrated onion than garlic, by weight (J.A. 54).

> ice an irrelevant and alien factor which is destructive of fair and free competition on the basis of merit. * * * In this situation, it is the relative size and conglomeration of business rivals, rather than economic efficiency, that may determine firm growth and success, and, ultimately, the allocation of resources. * * *

The Commission concluded that the merger which presented Consolidated with an opportunity to make sales in one product area "on the sheer strength of its buying power in other markets" (J.A. 66) posed a "real and substantial" threat to competition. In this connection, it found that a minimum of 25 percent of the onion and garlic market could be affected by the acquisition since, in 1958, producers that both supplied Consolidated and bought in volume from Gentry purchased around one-fourth of the entire industry's output of onion and garlic; that "many other prospective purchasers from Gentry could be influenced * * * by Consolidated" (J.A. 69–70); that, although Consolidated had "not chosen to systematize and vigorously enforce its reciprocal buying policy," it had actually used its reciprocity power on occasion to damage competitors unfairly (J.A. 70); and that the record did not show any "solid and effective external limitations" or "industry conditions" which would preclude Consolidated from effectively implementing a policy of reciprocal dealing on a much larger scale in the future (J.A. 70–71).

In reaching a judgment that the merger was likely substantially to lessen competition, the Commission placed primary emphasis upon the structure of the

dehydrated onion and garlic market. It noted that "With two firms accounting for better than 85% of both product lines for eleven successive years, maximum concentration short of monopoly has already been achieved" (J.A. 72). The acquisition and its creation of opportunities for reciprocal buying, the Commission held, "strengthened and solidified" this two-firm oligopoly, discouraged new entries, and constituted an anticompetitive obstacle "to the creation of genuinely competitive conditions" (J.A. 72–73). In conclusion, the Commission noted that the merger threatened those anticompetitive results "without producing any countervailing competitive, economic, or social advantages" (J.A. 75).

3. The Seventh Circuit reversed on the ground that the Commission had failed to sustain the burden of showing a probability that the merger would substantially lessen competition, reasoning that (App. A, *infra*, p. 22)—

> here ten years of post-acquisition experience—during which Consolidated attempted overt enforcement of reciprocal buying practice where it deemed it might be successful—serves to demonstrate that neither the acquisition of Gentry, in and of itself, nor the overt attempts to use buying power to influence sellers to Consolidated to purchase from Gentry resulted in substantial anticompetitive effect. No substantial impact on the relevant market occurred, and absent some factor which requires a different approach we are of the view that the experience reflected by this post-acquisition period must weigh heavily in appraising future probabilities.

REASONS FOR GRANTING THE WRIT

This is a case of major significance testing the legality under Section 7 of mergers which create a danger of foreclosing a substantial market through reciprocal buying.[7] Establishment of the principles governing the validity of such mergers will have an important bearing upon pending court cases as well as investigations of the Department of Justice and the Federal Trade Commission.[8] Because this is not a merger between competing firms or firms in a direct supplier-customer relationship, it raises new and important questions concerning the scope and application of Section 7 to "conglomerate" mergers.

The Court has never dealt with reciprocity as a competitive weapon, nor determined its significance under the antitrust laws. In recent years many concerns with substantial buying power have systematized the application of that power in reciprocity programs administered with varying degrees of finesse.[9] Indeed, recently, executives charged with handling reciprocity for their corporations formed an organization called the Trade Relations Association, which as of the end

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[7] See, *e.g.*, Handler, *Emerging Antitrust Issues: Reciprocity, Diversification and Joint Ventures*, 49 Va. L. Rev. 433; Hausman, *Reciprocal Dealing and the Antitrust Law*, 77 Harv. L. Rev. 873; Domnem, *Conglomerate Mergers and Reciprocity*, 8 Antitrust Bull. 283; Notes, 32 Geo. Wash. L. Rev. 832; 72 Yale L. J. 1265; 49 Va. L. Rev. 852.

[8] See, *e.g.*, *United States* v. *General Dynamics Corp.* Civ. No. 62–3686, S.D.N.Y., Nov. 8, 1962; *United States* v. *General Motors Corporation*, 61 Cr. 340, N.D. Ill., April 12, 1961; *United States* v. *General Motors Corporation*, 63–C–80, N.D. Ill., Jan. 14, 1963.

[9] Ammer, *Realistic Reciprocity*, Harv. Bus. Rev., Jan.–Feb. 1962, pp. 116 ff. And see references below in notes 10a and 10b.

of 1963 included 113 members.[10] The restrictive effects of reciprocity have been pointed out by lawyers and economists.[10a] Businessmen have been concerned about the ethical and long-run implications of reciprocity practices.[10b] But whatever may be the legality of reciprocity as a business practice, it is inherently anti-competitive in that, as the Commission noted, it substitutes considerations of economic power for the normal considerations of price, quality, and service (App. C, *infra*, pp. 35–36). It gives the large diversified company an unfair competitive advantage over the small, single-product manufacturer, since, as the Commission observed, a "single-line corporation is far less likely to both buy from and sell to another corporation than one that is diversified" (J.A. 64).[11] As a result of the acquisition, Consolidated can practice reciprocal buying because it both sells ingredients for food-products and purchases finished food products. Consolidated's competitors in the dehydrated garlic

[10] See Wall Street Journal, Dec. 4, 1963, p. 1. Among the members at that time were officials of such major corporations as American Machine & Foundry Co., El Paso Natural Gas Products, B. F. Goodrich Co., St. Regis Paper Co., and Owens-Corning Fiberglas Corp..

[10a] Stocking and Mueller, *Business Reciprocity and the Size of Firms*, 30 J. of Bus. of the Univ. of Chi. (1957) 73; Edwards, *Conglomerate Bigness as a Source of Power*, in Business Concentration and Price Policy (1955) 331 ff.; see articles cited, note 7 *supra*.

[10b] Teeple, *The P.A. Faces Reciprocity*, Purchasing, Jan. 1955, pp. 81 ff.; *Reciprocity, A Dilemma for Purchasing Agents*, Electrical World, Sept. 24, 1962, p. 45; *Reciprocity Smirks Behind the Sales Smile*, Chemical Week, Nov. 22, 1948, pp. 38 ff.; *Back Scratching Deals Raise Antitrust Ire*, Business Week, Feb. 9, 1963, pp. 45 ff.

[11] See Stocking and Mueller, *Business Reciprocity and the Size of Firms*, 30 J. of Bus. of the Univ. of Chi. 73 (1957).

and onion industry, being small firms which sell only dehydrated garlic and onion, can offer their customers no reciprocal purchases.

The record of the present case shows that Consolidated sought to use reciprocity as a means of obtaining business for Gentry (J.A. 250–251), and that Consolidated actually succeeded in compelling some of its suppliers to purchase dehydrated garlic and onion from Gentry (App. A, *infra,* p. 20; App. C, *infra,* pp. 40, 45).[12] But reciprocity can flourish with adverse effects on free and fair competition, even if the coercive power is not overtly exercised: even a large food processor may be influenced or induced to favor Consolidated as a supplier of dehydrated onion and garlic in the hope or expectation that, if it did so, Consolidated would be more likely to favor it as a supplier of food products to Consolidated. Whereas overt reciprocity can be and has been enjoined as an unfair method of

[12] J. J. Gielow & Sons, Inc., represents an instance where Consolidated's reciprocity power induced a supplier to shift his onion and garlic purchases from Basic to Gentry. The company's sales manager gave the following testimony with respect to the company's shift in its purchases (J.A. 1601):

> Q. Now, Respondent's Exhibit 380 shows that you bought almost all of your dehydrated onion and garlic from Basic up until 1953. Then it shows that your company purchased all of its dehydrated onion and garlic from Gentry in the years 1954 to 1958. Why did you buy exclusively from Gentry during those years?
>
> A. I was in Chicago calling on Consolidated and their buyer, I think it was Walter Wojack at that time, said to me, "Why don't you get the fellow from Gentry off my back? He is hounding me to have you buy the onion and garlic from him."
>
> So I returned to Detroit and I told Les of my conversation, and I told him that the price is the same, so "Let's get the fellow off of Wojack's back." And that is what we did.

competition,[13] the more subtle, but no less pernicious, forms of reciprocity cannot be prevented by an order in the nature of an injunction since they are inherent in the relationship of the parties. Only by keeping a firm like Gentry out of the hands of a concern like Consolidated can reciprocity be effectively eliminated. Section 7 of the Clayton Act, therefore, has a central role in any program of antitrust enforcement directed against the anticompetitive effects of reciprocity.

To apply Section 7 to a merger which will tend substantially to lessen competition because it will open the door to reciprocal buying is a correct application of the principles of Section 7. A merger which introduces an anticompetitive factor such as reciprocity into a market *per se* tends to lessen competition to some extent. See *Federal Trade Commission* v. *Morton Salt Co.*, 334 U.S. 37, 50. Whether the lessening is "substantial" depends upon the structure of the particular market affected. Here the Commission found that at a bare minimum—counting only those food processors, as of 1958, who both bought from Gentry and sold to Consolidated—25 per cent of all sales of dehydrated onion and garlic were subject to influence by "reciprocal buying" (App. C., *infra*, p. 44). As the Court made clear in the tying clause cases, when an inherently clogging practice is involved, its effect is "substantial" if it affects something more than an "insignificant or insubstantial" volume of business. *International Salt Co.* v. *United States*, 332 U.S. 392, 396; see *Northern Pacific R. Co.* v. *United States*, 356 U.S. 1, 6.

[13] See *Waugh Equipment Co.*, 15 F.T.C. 232; *Mechanical Mfg. Co.*, 16 F.T.C. 67; *California Packing Co.*, 25 F.T.C. 379.

The market in which the acquisition would have its anticompetitive effect was one in which, as the Commission found, "maximum concentration short of monopoly has already been achieved" (App. C., *infra*, p. 46). Consolidated's competitors, being small, single-line companies cannot employ reciprocity themselves to offset Consolidated's advantage. Consequently, they would be under pressure to sell out to large diversified companies which would be in a position to compete on equal terms. Further, the presence of a large company with opportunity, through reciprocal buying, to preempt a substantial share of the total market, would tend to discourage the entry of new competitors, particularly single-line companies unable to exercise reciprocal buying.

In condemning the merger in *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 332–333, and in *United States* v. *Aluminum Co. of America*, 377 U.S. 271, the Court emphasized the importance of preventing a trend toward concentration in the industry. It noted in *Aluminum Co.* (p. 280) that as the "condition [of oligopoly] develops, the greater is the likelihood that parallel policies of mutual advantage, not competition, will emerge." The same reasoning applies here, for Consolidated's acquisition of a reciprocal buying position not only diminishes the force of normal competitive practices but also reinforces the condition of near monopoly in the dehydrated onion and garlic industry.[14]

The court of appeals disturbed none of the findings of fact of the Commission nor did it discuss the Commission's theory of the case. It disposed of the

[14] See also *United States* v. *Philadelphia National Bank*, 374 U.S. 321, 365, n. 42.

subject of reciprocity by noting that "[u]ndoubtedly there are situations resulting from acquisitions or mergers in which business reciprocity has the effect of substantially lessening competition or can be so utilized" (App. A, *infra*, p. 21).[15] It held, however, that any inference of illegality in this case was rebutted by the post-acquisition evidence: (1) that Gentry had not increased its share of the market; and (2) that some customers who bought from Gentry, or who increased their purchases from Gentry, denied that they were influenced by the reciprocity practice (App. A., *infra*, p. 21). To give decisive weight to post-acquisition evidence as the court of appeals did here is inconsistent with the prophylactic function of the Antimerger Act. Further, the two circumstances do not in any sense demonstrate that the acquisition had not substantially lessened competition or might not do so in the future.

The fact that Gentry's market share did not increase substantially during a period of years following its acquisition by Consolidated is irrelevant on the question of whether the merger violates the Clayton Act. This Court so held in *Standard Oil Co.* v. *United States*, 337 U.S. 293, 308–314.[16] As the Commission in the present case pointed out (J.A. 73–74):

[15] A footnote to the court's opinion (App. A, *infra*, p. 21) reveals that it was referring only to the cases in which coercion was held to be an unfair competitive tactic under Section 5 of the Federal Trade Commission Act.

[16] The Court stated the issue in *Standard Oil* in terms which have precise application here (337 U.S. at 299): "The issue before us, therefore, is whether the requirement of showing that the effect of the agreements 'may be to substantially lessen competition' may be met simply by proof that a substantial portion of commerce is affected or whether it must also be demonstrated that competitive activity has actually diminished or probably will diminish."

> If reciprocal buying creates for Gentry a protected market, which others cannot penetrate despite superiority of price, quality, or service, competition is lessened whether or not Gentry can expand its market share. And if, as we find to be true here, the share of the market that may be insulated from the effective interplay of fair competitive forces is substantial, and the likelihood of such foreclosure is considerable, the merger cannot stand.

This is not a monopoly case. The Commission has never contended that as a result of the merger Gentry's market share would increase, in a few years, to a stated percentage. The vice of the merger is that it gave Consolidated an advantage which might work to foreclose competitors from a substantial share of the market, an advantage which it used and used successfully on occasion, and which might well have an effect without action on Consolidated's part.

The court of appeals' position that great weight should be given respondent's occasional failure to compel reciprocal buying is also fallacious, for, as the Commission pointed out (J.A. 70–71):

> That respondent has not chosen to systematize and vigorously enforce its reciprocal buying policy is of far less significance than that it obtained the *power* to do so by merger, and that by actually using its power on occasion to disadvantage competitors unfairly, respondent demonstrated that its possession of such power posed a real and substantial, and not merely abstract or theoretical, threat to competition.

Section 7 reads "may be", not "has". The

> evidence may show that respondent has not thus far severely impaired competition in the industry by reciprocity but it does not show that respondent may not do so when it chooses or that it will not so choose in the future. In other words, respondent's proof on this point reveals, at best, only past internal irresolution in implementing reciprocity rather than solid and effective external limitations on the power to exercise it.

Merely showing that some (but by no means all) of respondent's overt attempts to compel reciprocal buying failed is insufficient: reciprocity need not be overt in order to be successful and pernicious. Given the facts that Consolidated is a large buyer of food products the ingredients of which include dehydrated onion and garlic and that Consolidated was on occasion able actually to coerce reciprocal buying, it is apparent that reciprocity is a real and substantial, and not merely theoretical, danger to competition.

The Court, in *Federal Trade Commission* v. *Morton Salt Co.*, 334 U.S. 37, 50, made it clear that the Commission need not produce testimony to show that there is a "'reasonable possibility' that competition may be adversely affected" by a particular anticompetitive practice when the effect is self-evident. Like the higher price in a large inventory, as in *Morton Salt*, the precise impact of reciprocal buying may be difficult to single out, but its impact tends to weaken competition. The evidence before the Commission showed that the merger and creation of reciprocal buying power placed Gentry's competitors at a disadvantage in at least 25

percent of the dehydrated garlic and onion market; that Consolidated actually took business from competitors through the exercise of reciprocity power; and that the market was highly concentrated to begin with. These facts are sufficient to sustain the Commission's finding that the acquisition may substantially lessen competition. As in *Morton Salt*, the decision of the court of appeals in requiring additional evidence would greatly handicap effective enforcement of the Act.

CONCLUSION

This case presents questions of substantial importance in the enforcement of Section 7 of the Clayton Act which warrant review by this court. It is respectfully submitted that the petition for a writ of certiorari should be granted.

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AUGUST 1964.

APPENDIX A

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

No. 14197. September Term, 1963—January Session, 1964

CONSOLIDATED FOODS CORPORATION, *Petitioner,*

v.

FEDERAL TRADE COMMISSION, *Respondent.*

On Petition To Review an Order of the Federal Trade Commission

March 24, 1964

Before KNOCH and CASTLE, *Circuit Judges,* and MERCER, *District Judge.*

CASTLE, *Circuit Judge.* This case is before the Court on the petition of Consolidated Foods Corporation (hereinafter referred to as Consolidated) for review of an order of divesture issued by the Federal Trade Commission following an administrative hearing upon a complaint charging that Consolidated's acquisition of Gentry, Incorporated, violates Section 7 of the Clayton Act.[1]

[1] 15 U.S.C.A. § 18, the pertinent portion of which provides: "No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share

Consolidated was incorporated in 1941 as a wholesale grocery house. Subsequently, it expanded by mergers to encompass a wide variety of food industry enterprises. As of December 31, 1958,[2] it operated eight manufacturing divisions or subsidiaries engaged in processing canned soups, pickles, dressing, fruits, bakery goods, frozen foods, beet sugar, dehydrated onion, dehydrated garlic, and capsicum spices in plants located in eleven different states scattered across the country. In addition, it sold food products at wholesale through twelve units in an equal number of states, and at retail through three units, including the Piggly-Wiggly Midwest Co. and Klein Supermarkets, Inc., chains.

Consolidated acquired Gentry, Incorporated, on April 30, 1951. Both before and since that date Gentry has been a manufacturer of dehydrated onion and garlic and of assorted capsicum spices.[3] At the time of acquisition Gentry operated two plants and had assets valued at $1,600,000. Consolidated's assets were then approximately $60,000,000. Consolidated has exhibited a capacity for vigorous growth. By 1956 its assets exceeded $99,000,000 and its annual net sales of all products has risen to $286,252,695.

Dehydrated onion and garlic are sold primarily to food processors, and also to "institutional" users consisting of large restaurants, commissaries, steamship and large food servicing organizations, to distributors

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capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

[2] The complaint herein issued December 18, 1957.

[3] This case involves only Gentry's dehydrated onion and garlic business, which comprises the bulk of its trade.

which resell to food processors and institutional users, to spice grinders and repackagers which package spices for sale through retail stores, and to the government.

At the time of the challenged acquisition the industry consisted of only three domestic producers of both dehydrated onion and garlic. They were Gentry, Basic Vegetable Products, Inc., (Basic) and Puccinelli Packing Company (Puccinelli). One other concern, J. R. Simplot Company (Simplot) produced only dehydrated onion. Since that time Simplot has left the field for reasons having no bearing on the issues here involved. And, Gilroy Foods, Inc., which entered the field in 1959 was acquired in 1961 by McCormick Foods, Inc., whose requirements exceed Gilroy's output. In 1961 California Vegetable Concentrates, Inc., a wholly-owned subsidiary of General Foods Corporation (whose annual sales of a variety of food products exceed one billion dollars) announced plans to build a plant to process dehydrated onions, scheduled for completion late in 1961.

The trend toward ever increasing use of table-ready foods such as dehydrated soups, and the increasing acceptance of dehydrated onion and garlic as a substitute for fresh onion and garlic because of economy and quality control, are among the factors which have contributed to the significant growth in industry sales since 1950. For a period of eleven years Gentry and Basic have accounted for better than 85% of total industry sales. Immediately prior to the Consolidated-Gentry merger, Basic accounted for 60% and Gentry 28% of dehydrated onion sales. By 1958, these figures were 57% and 35%, respectively. In dehydrated garlic sales, Basic had 36% of the market in 1950 and 50% in 1958, while Gentry's shares were 51% and 39% for the same years.

As a wholesaler and retailer of food products, Consolidated buys from many food processors. A substantial number of these processors require dehydrated onion and garlic in packing their products. There is evidence that in a number of instances Consolidated overtly attempted to use its purchasing power as a device to obtain business for its Gentry division—to make sales of dehydrated onion and garlic to food processors from which Consolidated made purchases in connection with its wholesale and retail operations. But the record also reveals that this was not a matter of across-the-board company policy and that Consolidated recognized that for practical purposes the "I will buy from you if you will buy from me" reciprocity technique, in the setting here involved, had its limitations and that:

> . . . each situation has to be met individually as we certainly are in a better position to tell a private label supplier that he should use our raw materials, and by the same token we cannot tell a national supplier, such as Campbell Soup, as an illustration, that he must use our raw materials.

Although the Commission in its findings recognizes that "[t]he evidence may show that [Consolidated] has not thus far severely impaired competition in the industry by reciprocity . . ." even though Consolidated did "overtly exert this power on occasion with success" it concluded that "it seems clear that merely as a result of its connnection with Consolidated, and without any action on the latter's part, Gentry would have an unfair advantage over competitors enabling it to make sales that otherwise might not have been made" and "the acquisition of Gentry by Consolidated has conferred upon the latter the power to foreclose competition from a substantial share of

the markets for dehydrated onion and garlic, thereby jeopardizing the competitive opportunities of its small, relatively undiversified competitors and tending to lend further rigidity to an already heavily concentrated industry and to discourage the entry of new competitors, all 'without producing any countervailing competitive, economic, or social advantages'." On the basis of this conclusion, and subsidiary findings and conclusions underlying it, the Commission entered the divestiture order brought here for review.

The adverse effect upon competition requisite to application of the proscription of Section 7 of the Clayton Act and the invocation of the sanction of divestiture, is that the acquisition creates a reasonable probability of substantial injury to competition. "Mergers with a probable anti-competitive effect were to be proscribed . . ." *Brown Shoe Co.* v. *United States*, 370 U.S. 294, 323. Thus the main issue presented for our determination in this review is whether the Commission's implicit finding and conclusion that Consolidated's acquisition of Gentry has the probably substantial anti-competitive effect proscribed by Section 7 of the Clayton Act is supported by substantial evidence on the record considered as a whole.

Undoubtedly there are situations resulting from acquisitions or mergers in which business reciprocity has the effect of substantially lessening competition or can be so utilized.[4] Where the probability of such an effect arising out of a merger or acquisition is demonstrated the requirements for application of Section 7 are satisfied. But our examination of the record in

[4] See: *Waugh Equipment Co.*, 15 F.T.C. 232; *Mechanical Manufacturing Co.*, 16 F.T.C. 67 and *California Packing Corp.*, 25 F.T.C. 279.

the instant proceeding fails to satisfy us that the Commission sustained its burden of showing that such a probability exists. In our appraisal of the substantiality of the evidence we must take into account whatever in the record fairly detracts from its weight. *Universal Camera Corp.* v. *N.L.R.B.*, 340 U.S. 474, 488. And here ten years of post-acquisition experience—during which Consolidated attempted overt enforcement of reciprocal buying practice where it deemed it might be successful—serves to demonstrate that neither the acquisition of Gentry, in and of itself, nor the overt attempts to use buying power to influence sellers to Consolidated to purchase from Gentry resulted in substantial anticompetitive effect. No substantial impact on the relevant market occurred, and absent some factor which requires a different approach we are of the view that the experience reflected by this post-acquisition period must weigh heavily in appraising future probabilities.

Consolidated's Gentry division in the years following the acquisition, during which time it improved its onion processing equipment to eliminate a problem arising from the presence of wood splinters and achieved a product of higher quality than that of its competitors, increased its share of the rapidly expanding market by only some 7% with respect to dehydrated onion while, during the same period, it sustained a decrease of some 12% in its share of the dehydrated garlic market. If the increase in Gentry's market share of its onion business were attributable to business reciprocity—implied or overt—it seems that it should have similarly affected Gentry's garlic business.

Moreover, in a number of instances where there were overt attempts to utilize reciprocity there was testimony that it had no effect. The witnesses attrib-

uted their purchases or increase in amounts purchased to such factors as quality, better service, need for an additional source of supply, type of containers furnished, etc., and denied that reciprocity practice was a motivating factor in making purchases from Gentry. In the face of what the Commission found to be a "burgeoning" industry, the slight gain in over-all market position as to dehydrated onion when viewed in the light of the more significant loss of position with respect to dehydrated garlic indicates not only that reciprocity had no substantial impact but also that there is no basis for rejecting the testimony that even the overt attempts to utilize reciprocity as an influence had little effect on the firms involved. And this would seem especially so in the case of nationally known and advertised brands which through consumer acceptance and loyalty would be relatively immune from individual wholesaler or retailer dictation of the source from which ingredients must be obtained. By 1958 over 25% of Gentry's sales were to seven such companies and over 90% of its sales were to customers who purchased annual quantities in excess of 10,000 pounds each.

Probability can best be gauged by what the past has taught. We are convinced that the Commission has mistakenly rejected what the record demonstrates as to the past in favor of a future possibility based on conjecture and speculation.

The petition of Consolidated is granted and the Commission's order is set aside.

ORDER SET ASIDE.

741-870—64——4

APPENDIX B

JUDGMENT OF THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Tuesday, March 24, 1964

No. 14197

CONSOLIDATED FOODS CORPORATION, PETITIONER,

vs.

FEDERAL TRADE COMMISSION, RESPONDENT.

Petition for review of an order of the Federal Trade Commission

This cause came on to be heard on the petition for review of an order of the Federal Trade Commission, respondent's answer to said petition, and the transcript of the record from the Federal Trade Commission, and was argued by counsel.

On consideration whereof, it is ordered by this Court that the said petition for review of an order entered by the Federal Trade Commission on March 22, 1963, be granted, and the said order of the Federal Trade Commission be set aside, in accordance with the opinion of this Court filed this day.

APPENDIX C

OPINION OF THE FEDERAL TRADE COMMISSION

Docket No. 7000

IN THE MATTER OF CONSOLIDATED FOODS CORPORATION, A CORPORATION

Opinion of the Commission

By Commissioner Elman:

This is an appeal from an initial decision of the hearing examiner that the acquisition by respondent, Consolidated Foods Corporation, a large diversified processor and seller of food products, of the assets of Gentry, Incorporated, a company primarily engaged in the production of dehydrated onion and garlic, was proscribed by Section 7 of the Clayton Act (38 Stat. 731, as amended, 15 U.S.C. 18).[1] The ex-

[1] Section 7 provides in pertinent part:

"No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly."

aminer determined that the acquisition of Gentry by Consolidated "has the effect of substantially lessening competition and tending to create a monopoly in the relevant lines of commerce in violation of Section 7 of the Clayton Act, as amended." (Initial Decision, p. 20.) By way of remedy, his proposed order would require Consolidated to divest itself of Gentry within six months from its effective date.

I

Many of the facts, as found by the hearing examiner, are not in dispute. Respondent, a Maryland corporation with its office and principal place of business in Chicago, Illinois, was incorporated in 1941 as a wholesale grocery house. Subsequently, it expanded by merger to encompass a wide variety of food industry enterprises. As of December 31, 1958, respondent operated eight manufacturing divisions or subsidiaries engaged in processing canned soups, pickles, dressing, fruits, bakery goods, frozen foods, beet sugar, dehydrated onion, dehydrated garlic, and capsicum spices in plants located in eleven different states scattered across the continent. In addition, it sold food products at wholesale through twelve units in an equal number of states, and at retail through three units, including the well-known midwestern chains, Piggly-Wiggly Midwest Co. and Klein Supermarkets, Inc.

Respondent has exhibited a capacity for vigorous growth. Its net sales from July 1, 1950, to June 30, 1951, were $174,006,801. For the period July 1, 1955, to June 30, 1956, they had risen to $268,252,695. On June 30, 1951, respondent had assets of approximately $60,000,000. By June 30, 1956, the figure was more than $99,000,000.

Respondent's acquisition of Gentry, Incorporated, took place on April 30, 1951. Both before and since that date Gentry has been a manufacturer of dehydrated onion and garlic and of assorted capsicum spices. By comparison with Consolidated, Gentry is a small concern. At the time of acquisition, it operated two plants and had assets valued at $1,600,000.

This case involves only Gentry's dehydrated onion and garlic business, which comprises the bulk of its trade. When Gentry was acquired by Consolidated it had only three domestic competitors in the production and sale of dehydrated onion and two in dehydrated garlic. Since that time, one firm has left the onion field but another has entered both, so that four firms constitute the entire industry.[2] The domestic processing and sale of both dehydrated onion and dehydrated garlic are dominated by Gentry and one principal competitor, Basic Vegetable Products, Inc. In 1950, immediately prior to the Consolidated-Gentry merger, Basic accounted for 60% and Gentry 28% of dehydrated onion sales. By 1958, these figures were 57% and 35%, respectively. In dehydrated garlic sales, Basic had 36% of the market in 1950 and 50% in 1958, while Gentry's shares were 51% and 39% for the same years.

The industry as a whole is burgeoning due to the development in recent years of new foods, such as dehydrated soups, containing its products. In 1950, total industry sales of dehydrated onion equalled 7,802,159 pounds, of which Basic sold 4,693,360 and Gentry 2,158,880. By 1958, industry sales were 18,-

[2] Competition from foreign imports has not been great in the years under consideration. For example, in 1958 imported onion sales equalled less than 4% of sales of domestically produced onion, and imported garlic only a little more than 2% of domestic garlic.

147,207 pounds, with Basic accounting for 10,420,944 pounds of this total and Gentry 6,259,171. The industry produced 1,799,518 pounds of dehydrated garlic in 1950; by 1958, the total was 5,127,042 pounds. During the corresponding period Basic's sales moved from 652,059 pounds to 2,575,041, and Gentry's from 922,073 pounds to 1,979,834.

II

Under Section 7 of the Clayton Act a merger is unlawful if its likely effect would be to lessen competition substantially in the relevant product and geographical markets. It is agreed that Consolidated and Gentry were not competitors prior to this merger and that sales by Gentry to Consolidated were insubstantial. Thus, the acquisition did not involve the kind of competitive effects usually associated with "horizontal" or "vertical" mergers in the ordinary usage of those terms. See *Brown Shoe Co.* v. *United States,* 370 U.S. 294.

The gravamen of this proceeding was that the merger was illegal under Section 7 of the Clayton Act because it created the serious danger that Gentry would acquire a protected market, in which fair competitive opportunities would be denied to other sellers of dehydrated onion and garlic, as a result of the trade practice known as "reciprocity." Section 7 is designed, of course, to "nip in the bud" such changes in the structure of an industry, produced by corporate acquisitions, as are likely to bring about substantial lessening of competition. It must be emphasized at the outset that in a Section 7 case (as distinguished from a Sherman Act case or a proceeding under Section 5 of the Federal Trade Commission Act), the inquiry does not focus on overt anticompetitive trade practices as such, but rather on changes in market

or industry structure that are effected by the challenged merger and that may have anticompetitive consequences. Thus, in this case the inquiry must focus on the likely effect of the Consolidated-Gentry merger on the competitive forces at play in the dehydrated onion and garlic industries.

As generally understood, reciprocity describes the practice whereby firms, overtly or tacitly, make concessions to one another in order to promote their own business interests. Perhaps the most common form of reciprocity is the type involved in this case—reciprocal buying. In this context it involves nothing more than the simple idea that "I will buy from you if you will buy from me", or the unspoken "If I buy from him, he will buy from me".

The situation before us here, for example, is relatively straightforward. As a wholesaler and retailer of foods, Consolidated buys the products of many food processors. A substantial number of these processors require dehydrated onion and garlic in packing their foods. It can be readily understood that food processors who use dehydrated onion or garlic and are anxious to sell or to continue to sell their products to Consolidated will, to say the least, consider Gentry's connection with Consolidated in selecting a source of supply of onion and garlic. Indeed, complaint counsel contends, and the hearing examiner found, that Consolidated relied on the influence generated by its buying power to induce these processors to purchase onion and garlic from its Gentry Division. The examiner's conclusions in this regard were as follows:

> "The acquisition of Gentry gave Consolidated the opportunity to use express or implied business coercion to induce suppliers purchasing dehydrated onion and garlic from other sources to purchase some or all of their requirements

from the Gentry Division of Consolidated. There is ample evidence in the record that both Gentry and Consolidated have exercised pressure and have attempted to influence, by affirmative action, some of Consolidated's suppliers to purchase a substantial part if not all of their dehydrated onion and garlic requirements from Gentry. Consolidated was successful in some instances, even though objections had been raised as to the quality of Gentry's products as compared with the products of its competitors. This indicates the value of the so-called reciprocity policy, when used as a competitive weapon." (Initial Decision, p. 9)

III

While contending that the reciprocity aspect of the Consolidated-Gentry merger is less restrictive of competition than a vertical merger, respondent does recognize an analogy between the two types of merger. In a vertical merger the danger to competition lies in the likelihood that the union of previously independent supplier and customer companies will foreclose their share of the market to competitors who previously had an equal opportunity either to buy from the supplier company or to sell to the customer company. So too with reciprocity resulting from a conglomerate or diversification merger. Here competition will be adversely affected if the reasonable likelihood arises that Gentry's competitors will be to some degree foreclosed by the Gentry-Consolidated merger from having the opportunity of selling to that portion of the market composed of Consolidated's suppliers. Consequently, the extent of potential foreclosure greatly exceeds that resulting from

the slight vertical relationship existing between Gentry and Consolidated.

To satisfy the requirements of Section 7, it must be shown that the effect of the acquisition may be *substantially* to lessen competition. Respondent asserts that proof of such substantiality is not only lacking here but that the contrary has been affirmatively demonstrated. Respondent's evidence on this point consists principally of (a) a statistical presentation indicating that Gentry has not come to dominate the industry in the years since the merger, and (b) the testimony of a number of witnesses who stated that they began buying Gentry products only for valid business reasons, *e.g.*, because Gentry had improved its manufacturing process, or because the buyer decided that he preferred having at least two sources of supply.

These contentions, coupled with the requirements of Section 7, appear to necessitate resolution of three separate questions if the examiner's finding of violation is to be upheld. First, is business reciprocity, as it is presented here, anticompetitive in its effect? Second, if the answer to this question is in the affirmative, did Consolidated's acquisition of Gentry transform sufficiently the market structure of this industry to create an environment conducive to anticompetitive reciprocity? Third, if both answers are yes, is the threat to competition sufficiently substantial to bring the merger within the prohibitions of Section 7?[3]

[3] The answer to a fourth question, whether the market affected is substantial (see, *e.g.*, *United States* v. *E. I. duPont de Nemours & Co.*, 353 U.S. 586, 595), is not open to doubt. The geographic market is the entire United States. The product markets encompass all dehydrated onion and garlic, of whatever price, quality, or characteristics, produced in this country.

IV

The anticompetitive effect of business reciprocity is made clear by three cases in which the Commission held that overt and coercive implementation of reciprocity is an unfair method of competition in violation of Section 5 of the Federal Trade Commission Act (38 Stat. 719, as amended, 15 U.S.C. § 45). In the first of these, *Waugh Equipment Co.*, 15 F.T.C. 232, high officials of the large meat packing concern, Armour & Co., acquired stock in the Waugh Equipment Co., a minor manufacturer of draft gears, and commenced to use Armour's vast power as a major rail shipper to induce railroad companies to buy draft gears from Waugh. Although Waugh's gear was practically unkown in 1924, when the reciprocity campaign commenced, the company was enabled to vault from obscurity to industry leadership in only six years. Its share of the market for draft gears for new freight equipment rose from less than 1% in 1924 to approximately 35% in 1930.

In finding a violation of Section 5, the Commission pointed out that other draft-gear manufacturers made their sales presentations to the mechanical, operating, and purchasing departments of the railroads, rather than to their traffic departments, and that the factors ordinarily considered by the railroads were

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And the dollar volume of business is significant, as the following table, taken from figures compiled by respondent, indicates.

	Dehydrated onion	Dehydrated garlic
Basic, 1950	$2,330,067	$438,679
Gentry, 1950	1,139,033	621,403
Industry, 1950	3,905,830	1,200,197
Basic, 1958	5,913,321	1,947,723
Gentry, 1958	3,547,338	1,536,508
Industry, 1958	10,145,606	3,831,099

price, quality, and salesmanship. The Commission further found that the efforts of the Armour officials on Waugh's behalf resulted, in many instances, in railroads purchasing Waugh gears contrary to the recommendations of their mechanical officials and in disregard of the bids of competitors. Those competitors had no appreciable traffic to offer the railroads and were therefore unable to meet Waugh's competition.

The Commission concluded that Waugh and the Armour officials had "taken advantage of a competitive weapon, oppressive and coercive in nature", which tended unduly to suppress competition by preventing customers "from exercising their free will and judgment in determining which device is the most efficient and will best serve their needs at the lowest net cost over a period of time". (15 F.T.C., at 246, 247) The respondents had "thus injected an element in the competitive field" which was "unfair and abnormal" and tended "to reduce the efficiency and economy in the production and sales methods of competing manufacturers and [give] to the concern that control[led] the largest volume of freight traffic an unfair advantage that [would] more than offset the higher efficiency in the production and sales methods of competing concerns which control[led] no such traffic. . . ." (*Id.*, at 247)

Mechanical Manufacturing Co., 16 F.T.C. 67, was a similar case. There important employees of the large packer, Swift & Co., along with the Swift Estate and members of the Swift family, controlled Mechanical Manufacturing Co., a maker of such railroad equipment as draft gears, bumping posts, and coupler centering devices. As in the *Waugh* case, railroads were persuaded to buy Mechanical's products by promises of future Swift & Co. freight traffic and

threats of withdrawal of existing traffic. When necessary, Swift shipments actually were diverted from railroads that failed to comply and to railroads that did buy from Mechanical. Again the Commission found that the Federal Trade Commission Act had been violated.[4]

In *California Packing Corp.*, 25 F.T.C. 379, as in the case before us, the practitioner of reciprocity, California Packing Corporation, was a large diversified processor and distributor of many different kinds of food products. One of its subsidiaries was Encinal Terminals, a corporation operating wharves, sheds, warehouses, and switch tracks on San Francisco Bay for the purpose of handling rail and steamship freight at the waterfront. By promising, or threatening, to shift their purchases of raw and manufactured materials, California Packing and its officers and subsidiaries placed pressure on their suppliers to divert their freight shipments from other terminal companies to Encinal. Similarly, steamship companies were coerced into diverting freight tonnage to Encinal Ter-

[4] The problem of reciprocity in rail-traffic routing is also considered in *In the Matter of Reciprocity in Purchasing and Routing*, 188 I.C.C. 417. The Interstate Commerce Commission found the practice "burdensome" to the public transportation system in that "it succeeds only in making the handling of existing traffic more expensive." (188 I.C.C., at 433, 434) The Commission also noted the unfair and anticompetitive aspect of the practice:

> "The manufacturer of railway materials or supplies who has little traffic to offer as an inducement is at a serious disadvantage although its product may be superior and its prices comparable. The smaller carriers with limited purchasing power are likewise at a disadvantage in securing traffic although their services are prompt and efficient, and their rates on a parity with those of their larger competitors." (188 I.C.C., at 433)

minals, even when the move was uneconomical for them, by the employment of California Packing's power as an important shipper. Even California Packing's competitors were exploited by the device of soliciting their customers and suppliers to induce them to divert shipments through Encinal Terminals.

The Commission found that the "principal consideration" for California Packing's purchases from its suppliers became "the volume of tonnage routed by said industrial concerns through the said Encinal Terminals * * * instead of the usual and normal competitive considerations such as quality, service, and price * * *." (25 F.T.C., at 398–399) The practices disclosed were held unfair methods of competition.

These decisions represent specific applications of the general principle that abuse of large buying power to restrict competitive market opportunities is illegal. As the Supreme Court has held:

> "Large-scale buying is not, of course, unlawful per se. It may yield price or other lawful advantages to the buyer. It may not, however, be used to monopolize or to attempt to monopolize interstate trade or commerce. *Nor * * * may it be used to stifle competition by denying competitors less favorably situated access to the market.*" (*United States* v. *Griffith*, 334 U.S. 100, 108, emphasis added.)

This is precisely the vice of reciprocity as manifested in the cases mentioned above. It transforms substantial buying power into a weapon for "denying competitors less favorably situated access to the market". It distorts the focus of the trader by interposing between him and the traditional competitive factors of price, quality, and service an irrelevant and alien factor which is destructive of fair and free competition on the basis of merit. The efficient pro-

ducer may thereby suffer loss because of a circumstance extrinsic to the worth of his product. In this situation, it is the relative size and conglomeration of business rivals, rather than economic efficiency, that may determine firm growth and success, and, ultimately, the allocation of resources. Obviously, this practice strikes at one of the basic premises of a free enterprise economy. And it is clear that these anticompetitive effects are likely to occur, given a corporate structure similar to that of respondent in this proceeding, without the crudities involved in the three cited cases or indeed without any action whatsoever on the part of the parent corporation. It is certainly obvious, to use an example based on the facts of this case, that a food processor who uses dehydrated onion or garlic and who seeks to curry Consolidated's business will tend to prefer Gentry as his source of supply, and the advantages accruing to him from so favoring Gentry would not have to be pointed out by Consolidated.

In many respects, reciprocal buying bears a close resemblance to the unlawful business practice of entering into tying arrangements, *i.e.*, agreements by one party to sell one product only on condition that the buyer also purchase a different product. The latter product is said to be "tied" to the former.

> "Where such conditions are successfully exacted competition on the merits with respect to the tied product is inevitably curbed. Indeed 'tying agreements serve hardly any purpose beyond the suppression of competition.' *Standard Oil Co. of California* v. *United States*, 337 U.S. 293, 305, 306. They deny competitors free access to the market for the tied product, not because the party imposing the tying requirements has a better product or a lower price but because of his power or leverage in

> another market. At the same time buyers are forced to forego their free choice between competing products. * * *" *Northern Pacific Railway Co.* v. *United States*, 356 U.S. 1, 6.

Similarly, reciprocal buying may also enable one seller to succeed over another not on the basis of "a better product or a lower price but because of his power or leverage in another market", *viz.*, the market in which the seller is an influential buyer of other products. A frequent condition, expressed or implied, of his purchase of goods from his supplier is that the supplier also buy from him. The prospective customer "ties" the sale of his product to his purchases from his supplier and "competition on the merits with respect to the tied product is inevitably curbed."

It is for these reasons that the Commission held in the *Waugh Equipment, Mechanical Manufacturing,* and *California Packing* cases that coercive exercise and reliance on business reciprocity is an unfair method of competition within the meaning of Section 5 of the Federal Trade Commission Act. And, in view of respondent's coercion, were this a proceeding under Section 5 an order to cease and desist would be entirely justified. However, this proceeding was brought not under Section 5 but under Section 7 of the Clayton Act, and the order issued by the hearing examiner calls not for termination of anticompetitive conduct but for divestiture of the acquired firm. We must therefore proceed to consider, in the context of Section 7, whether the merger here has brought about a change in the structure of the industry whose effect—in relation to reciprocity—may be substantially to lessen competition.

V

It is elementary that the effect of a merger, rather than its technical label, determines its validity. An

acquisition of one corporation by another need not be of an orthodox horizontal or vertical nature for Section 7 to apply. The legislative history of amended Section 7 makes it clear "that the bill applies to all types of mergers and acquisitions, vertical and conglomerate as well as horizontal, which have the specified effects of substantially lessening competition . . . or tending to create a monopoly." (H.R. Rep. No. 1191, 81st Cong., 1st Sess., p. 11.) As the Supreme Court has recently stated, "by the deletion of the 'acquiring-acquired' language in the original text, [Congress] hoped to make plain that § 7 applied not only to mergers between actual competitors, but also to vertical and conglomerate mergers whose effect may tend to lessen competition in any line of commerce in any section of the country." *Brown Shoe Co.* v. *United States*, 370 U.S., 294, 317.

The adverse effect which reciprocal buying may have upon competition has already been demonstrated. The way in which a conglomerate merger may enhance the likelihood that reciprocity may be practiced to stifle competition is equally clear.

A single-line corporation is far less likely to both buy from and sell to another corporation than one that is diversified—*i.e.*, if it deals in a variety of product or service lines. A glance at the cases discussed in Part IV, *supra*, makes this apparent. The officials of Armour & Co. and Swift & Co. could not exercise reciprocal buying power over the railroads so long as their companies produced only meat products, which the railroads did not consume. But once they established relationships with firms that produced railroad equipment, they could employ Armour and Swift power as shippers of meat products to force the railroads to buy the equipment from the sources in which they were interested. It was pre-

cisely the lack of diversification that prevented other equipment manufacturers from meeting the reciprocity competition generated by Armour and Swift. Similarly, California Packing Corp's use of reciprocity depended upon linking the purchase of supplies and transportation for its food products to the operation of a wholly unrelated terminal business. In sum:

> "The large diversified firm has better opportunities for using reciprocal buying than the single-line producer. . . . A firm that makes many products can more readily find a supplier that is also a potential buyer of what it makes. And, if it is a large purchaser, it may readily persuade its supplier to buy from it. If a mere suggestion is not adequate, a threat to withhold patronage may do the trick. . . .
>
> "Diversification not only increases the number of opportunities for reciprocal buying; it increases their magnitude. A single-line producer, even though a near-monopolist, may buy so little of some material that reciprocal buying has little influence on suppliers as potential customers. But by diversifying—making other products requiring the same input—a firm may so enlarge its buying as to give it the power to increase its sales. . . .
>
> ". . . The large diversified firm producing for sale to other industries has an advantage in the strategy of reciprocal dealing." (Stocking and Mueller, "The Business Reciprocity and the Size of Firms", *The Journal of Business of the University of Chicago*, Vol. XXX, pp. 73, 76–77 (1957))

Hence, to the extent that a diversification, or conglomerate, merger produces an industry structure

that facilitates and furthers reciprocal buying, it is likely to lead to the most serious of anticompetitive consequences, *viz.*, to confer upon large, diversified corporations a crushing weapon against small, single-line competitiors. The potential practical consequences are dramatically illustrated in the *Waugh* case, discussed earlier. The danger of such consequences, we must find, also exists here as a practical reality.

Consolidated's acquisition of Gentry presented it with an opportunity, previously unavailable, to reap a profit from sales in one product area, dehydrated onion and garlic, on the sheer strength of its buying power in other markets, and not on the basis of "a better product or a lower price". Furthermore, Consolidated did, again admittedly, overtly exert this power on occasion with success. The evidence shows that other established onion and garlic producers, Basic Vegetable Products, Inc., and Puccinelli Packing Co., lack Consolidated's size and diversification, and are thus ill-equipped to respond in kind. It is in the context of just such an industry structure that a reciprocal buying policy has the greatest chance of success and therefore poses the most serious threat to competition.

Since Consolidated acquired the power to extort or simply attract reciprocal purchases from suppliers when it acquired Gentry, the causal relationship between the merger and the injury to competition implicit in reciprocal buying is patent. While respondent has admitted the overt exercise of the power inherent in its corporate structure, expressly conditioning purchases from processors on their purchases from Gentry, it seems clear that merely as a result of its connection with Consolidated, and without any action on the latter's part, Gentry would have an un-

fair advantage over competitors enabling it to make sales that otherwise might not have been made.

Section 7 is the appropriate statute for dealing with the problem of eliminating anticompetitive effects directly attributable to a merger in their incipiency. Respondent's argument that the Commission should rely on Section 5 of the Federal Trade Commission Act as an exclusive remedy in this case is without merit. Congress did not consider it sufficient to provide *post hoc* procedures to enjoin anticompetitive behavior. Rather, Section 7 was designed to abort such changes in industry structure that would have anticompetitive effects, a concept that is not in any sense confined to unfair methods of competition within the meaning of Section 5 of the Federal Trade Commission Act. Though neither the absence of competition between two arms of the single corporation nor intra-corporate sales might be unfair methods of competition, in a Section 7 proceeding the inquiry frequently focuses on the anticompetitive effect of anticipated business practices that would be immune from legal attack had the structure of the merged corporation been developed by growth rather than acquisition. Therefore, in this case, it might be agreed that a cease and desist order would eliminate such overt reliance on reciprocity by Consolidated as might be proved, but it would do nothing to eliminate the anticompetitive effect inherent in the corporate structure created by the merger.

VI

Is the anticompetitive potential of the Consolidated-Gentry merger sufficiently substantial to render the merger unlawful?[5] In considering this question, we

[5] It is agreed that dehydrated onion and dehydrated garlic constitute the lines of commerce involved in this proceeding and that the relevant market area is the whole United States.

are aware that Congress did not intend Section 7 to apply only to the "mere possibility" that competition may be substantially lessened. Conversely, "A requirement of certainty and actuality of injury to competition is incompatible with any effort to supplement the Sherman Act by reaching incipient restraints." (S. Rep. No. 1775, 81st Cong., 2d Sess., p. 6.)

> "Congress used the words '*may be* substantially to lessen competition' (emphasis supplied), to indicate that its concern was with probabilities, not certainties. Statutes existed for dealing with clear-cut menaces to competition; no statute was sought for dealing with ephemeral possibilities. Mergers with a probable anti-competitive effect were to be proscribed by this Act." (*Brown Shoe Co.* v. *United States, supra,* at p. 323)

What then are the "probabilities" here? Once again, the *Brown Shoe* opinion is illuminating. In discussing the vertical aspects of the merger between Brown Shoe Co. and G. R. Kinney Co., the Court described a spectrum of types of restraints on competition that may result, in varying degrees, in foreclosing a share of a market to competitiors. It distinguished in particular between exclusive-dealing contracts and tying agreements. The former, it said, "are frequently negotiated at the behest of the customer who has chosen the particular supplier and his product upon the basis of competitive merit", and under certain circumstances "may escape censure. . . ." (370 U.S., at p. 330)

Tying agreements, on the other hand, "can rarely be harmonized with the strictures of the antitrust laws. . . ." (*Ibid.*) The Court explained:

> "The usual tying contract forces the customer to take a product or brand he does not necessarily want in order to secure one which he

> does desire. Because such an arrangement is inherently anticompetitive, we have held that its use by an established company is likely 'substantially to lessen competition' although only a relatively small amount of commerce is affected. . . ." (*Ibid.*)

As stated earlier, tying agreements and reciprocal buying are closely analogous in anticompetitive effect. In the latter, the customer is forced "to take a product or brand he does not necessarily want" in order to make a sale. That the similarity between a merger and a tying agreement is an appropriate consideration under Section 7 is also apparent from *Brown Shoe,* since the resemblance between one aspect of Brown's relationship to Kinney and a tying clause was mentioned by the Court as a consideration supporting a finding of violation. (*Id.,* at p. 337) By acquiring Gentry, Consolidated has provided itself with a basis on which to "tie" sales to its supplier to purchases from them.

Certainly the area of competition threatened by the Consolidated-Gentry merger greatly exceeds the "relatively small amount of commerce" the Court has considered necessary to invalidate a tying agreement. This is revealed by examining Gentry's sales to suppliers of Consolidated. In 1958, to cite the most recent year for which figures are available, Gentry held 35% of the market for dehydrated onion and 39% for dehydrated garlic. Its sales of each, in pounds, were 6,259,171 and 1,979,834, respectively. Respondent has undertaken to tabulate (Respondent's Proposed Findings of Fact and Conclusions of Law, pp. 99–101) Gentry's sales to major customers—defined as customers that purchased 10,000 pounds of onion and garlic from Gentry in any year from 1946 to 1958—that were also suppliers of Consolidated.

For 1958, these sales came to 4,617,145 pounds of onion and 1,263,690 pounds of garlic. Translated into market shares, firms that both supplied Consolidated and bought in volume from Gentry purchased more than 25% of the onion produced by the industry and not quite 25% of the garlic.

Hence, in both the onion and garlic product lines approximately one-fourth of the available market stands to be influenced by the possibility that Consolidated will withdraw patronage unless Gentry is in turn patronized. But this is only the most conservative calculation of the potential scope of reciprocity at Consolidated's command. Certainly many other prospective purchasers from Gentry could be influenced by the expectation or promise of reciprocal purchases of their products by Consolidated. The latent force of Consolidated's buying power therefore undoubtedly exceeds one-fourth of both markets by a substantial margin. The area of prospective market foreclosure is thus not merely significant, but exceptionally large.

Because, again, Section 7 requires us to deal in "probabilities", potential foreclosure of a major share of the market weighs strongly against the lawfulness of a merger—especially a merger that threatens consequences like these of a tying agreement. But there are other factors, mentioned in *Brown Shoe* as appropriate for consideration, which point in the same direction.

First, the Court indicated that past behavior of the merging firms may be significant in showing potential market foreclosure. (370 U.S., at p. 332) Here, past behavior reveals actual use of reciprocity by Consolidated in pushing Gentry's products. Respondent argues, however, that the record discloses that reciprocal buying was employed only sporadically

and with limited success. We think this contention misconceives both the point of Section 7 and the significance of the reciprocity evidence of record. That respondent has not chosen to systematize and vigorously enforce its reciprocal buying policy is of far less significance than that it obtained the *power* to do so by merger, and that by actually using its power on occasion to disadvantage competitors unfairly, respondent demonstrated that its possession of such power posed a real and substantial, and not merely abstract or theoretical, threat to competition.

Section 7 reads "may be", not "has". The evidence may show that respondent has not thus far severely impaired competition in the industry by reciprocity but it does not show that respondent may not do so when it chooses or that it will not so choose in the future. In other words, respondent's proof on this point reveals, at best, only past internal irresolution in implementing reciprocity rather than solid and effective external limitations on the power to exercise it.

Any suggestion that such power cannot effectively be exploited fails to account for clear-cut historical instances when it has been. Consider, for example, the dramatic effect of reciprocity in *Waugh Equipment Co.*, discussed earlier, where the acquired firm was enabled to leap from insignificance to control of 35% of the market and industry leadership in only six years.[6] Respondent has given us no reason to believe that industry conditions preclude its achieving similar results. Indeed, as we pointed out in part

[6] For other instances in which reciprocal buying by large diversified firms may seriously hamper small single-line competitors, see Stocking and Mueller, "Business Reciprocity and the Size of Firms", XXX *The Journal of Business of the University of Chicago* 73 (1957).

V, *supra,* the industry structures seems tailor-made to the exploitation of reciprocal buying power.

Second, the Supreme Court attached importance in *Brown Shoe* to the trend of concentration in the industry. (*Id.*, at p. 37). Here, no such trend appears, but the industry is already so highly concentrated that there is hardly room in which a "trend" could develop.[7] With two firms accounting for better than 85% of both product lines for eleven successive years, maximum concentration short of monopoly has already been achieved. If it is desirable to prevent a trend toward oligopoly[8] it is *a fortiori* desirable to remove, so far as possible, obstacles to the creation of genuinely competitive conditions in an oligopolistic industry. Respondent's reciprocal buying power, obtained through acquisition of Gentry, is just such an anticompetitive obstacle.

This conclusion is buttressed by the peculiar nature of the dehydrated onion and garlic industry. In the first place, the record shows that Gentry's leading competitor, Basic Vegetable Products, Inc., has been the innovator and leader in the field. Gentry has recently made technical strides narrowing, although probably not closing, the gap between them. There is also evidence that the third firm, Puccinelli Packing Co., is not only much smaller—commanding only about 10% of each product market—but is considered by many buyers to offer an inferior product and inferior service.

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[7] One "trend", however, is highly possible. Other diversified food firms may follow Consolidated's lead and seek to acquire the remaining industry members for reciprocity purposes. This development would stifle fair competition on an industry-wide basis.

[8] See *Brown Shoe Co. v. United States*, 370 U.S., at pp. 332–33.

Coupled with this industry structure is the fact, well-documented by respondent, that many buyers have determined that their source of supply may best be protected by a policy of buying from two suppliers. When the inducement of reciprocal buying is added as a third ingredient, the probable result becomes clear. Buyers are likely to lean toward Basic on the ground of quality, but, in seeking a second, protective supply channel, to purchase from Gentry in the belief that this will further their sales to Consolidated. Not only does Gentry thus obtain sales that might otherwise go to Basic or Puccinelli, but the two-firm oligopoly sturcture of the industry is strengthened and solidified and new entry by others is discouraged.[9]

Third, and closely related to the problem of oligopoly, is the matter of maintaining competitive vigor in the industry. Respondent seems to think that it cannot be found to have violated Section 7 since it has not driven competitors from the field or sharply curtailed their sales. But we have already indicated that our inquiry must focus on *probable* effect, and that one such probable effect of respondent's acquisition of Gentry is the discouragement of new competition. This could occur even if Gentry does not drive competitors from the field or attain unilateral industry dominance. If reciprocal buying creates for Gentry a protected market, which others cannot penetrate despite superiority of price, quality, or service, competition is lessened whether or not

[9] Neither the departure from the industry of J. R. Simplot Co., nor the entry of Gilroy Foods, Inc. (later purchased by McCormick & Co.) appears particularly significant here. Simplot seems to have switched to another field for reasons extrinsic to the competitive picture in the onion and garlic industry. Gilroy's entry is too recent to permit assessment of its probable role, especially in view of its acquisition by McCormick, a large user of both onion and garlic.

Gentry can expand its market share.[10] And if, as we find to be true here, the share of the market that may be insulated from the effective interplay of fair competitive forces is substantial, and the likelihood of such foreclosure is considerable, the merger cannot stand.

The Supreme Court has said that "remaining vigor cannot immunize a merger if the trend in that industry is toward oligopoly." (*Brown Shoe Co.* v. *United States, supra,* at p. 333) Nor can it "immunize a merger" if pre-existing oligopoly is thereby significantly reinforced or more firmly entrenched. "Vigor" of competition is diminished, rather than increased, by a merger that adds an anticompetitive element to an already overwhelmingly concentrated industry. Of course, a merger escapes the proscription of Section 7 if its likely effect is to promote, rather than hinder, competition. This might be true, for example, if the acquired corporation were a "failing company" being purchased by a newcomer to the industry, or if two small companies must combine in order to compete effectively with larger corporations dominating the industry. (See *Brown Shoe Co.* v. *United States,* 370 U.S., at pp. 319, 331) But no such procompetitive effects can be discerned in the merger here. Indeed, it is difficult to see how the quasi-tying-agreement effect of reciprocal buying fostered by the

[10] It is for this reason that we reject respondent's argument that the decline in its share of the garlic market proves the ineffectiveness of reciprocity. We do not know that its share would not have fallen still farther, had it not been for the influence of reciprocal buying. This loss of sales fails to refute the likelihood that Consolidated's reciprocity power, which it has shown a willingness to exploit to the full, will not immunize a substantial segment of the garlic market from normal quality, price, and service competition.

union of Consolidated and Gentry can be anything but anticompetitive.[11]

In *Brown Shoe*, the Court concluded that the Brown-Kinney merger was likely substantially to lessen competition:

> "because the trend toward vertical integration in the shoe industry, when combined with Brown's avowed policy of forcing its own shoes upon its retail subsidiaries, may foreclose competition from a substantial share of the markets for men's, women's, and children's shoes, without producing any countervailing competitive, economic, or social advantages."

So here, we must conclude that the acquisition of Gentry by Consolidated has conferred upon the latter the power to foreclose competition from a substantial share of the markets for dehydrated onion and garlic, thereby jeopardizing the competitive opportunities of its small, relatively undiversified competitors and tending to lend further rigidity to an already heavily concentrated industry and to discourage the entry of new competitors, all "without producing any countervailing competitive, economic, or social advantages."[12]

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[11] Respondent has suggested that reciprocity business gained by its acquisition of Gentry is offset by business Gentry has lost due to competitors of Consolidated not wishing to patronize one of its divisions. But this hardly establishes that the "vigor of competition" has been preserved. Instead it shows that the merger has lent additional rigidity to the market by establishing a class of customers immune to Gentry's sales efforts. The free play of competitive forces is thus further curbed.

[12] *Cf.*, *Reynolds Metals Co.* v. *Federal Trade Commission*, (D.C. Cir., decided Sept. 27, 1962), slip opinion, p. 12:

> "Arrow's assimilation into Reynolds' enormous capital structure and resources gave Arrow an immediate advantage over its competitors who were contending for a share of the market for florist foil. The power of the 'deep pocket' or 'rich parent' for one of the florist foil

VII

The final question concerns the appropriate relief to be ordered. The hearing examiner directed respondent to divest itself within six months of all assets obtained through acquisition of Gentry, together with subsequent additions thereto, in such a manner as to restore Gentry as a going concern in the production and sale of dehydrated onion, garlic, and other products. The examiner's order would prohibit distribution of the stock or assets of Gentry to any officer, director, stockholder, employee, or agent of Consolidated. Respondent objects (a) that there is no reason to prevent a "spin-off" of Gentry to existing shareholders of Consolidated, and (b) that the six-month time limit imposes an unreasonable burden. Significantly, respondent does not argue that divestiture, in whatever form, is not here, as it normally is, the proper remedy. That proposition we take to be conclusively established by *United States* v. *E. I. duPont de Nemours & Co.*, 366 U.S. 316, which held that divestiture, "that most drastic, but most effective, of antitrust remedies," is "peculiarly appropriate in cases of stock acquisitions which violate § 7." 366 U.S., at 326, 328.

In this case, divestiture is indeed peculiarly appropriate. As we have pointed out, a cease and desist order would prevent further overt effort by respondent to obtain business for Gentry through reciprocity, but it could not remove the attraction, implicit in the Consolidated-Gentry relationship, which is now well-known in the industry, for suppliers or prospective

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suppliers in a competitive group where previously no company was very large and all were relatively small opened the possibility and power to sell at prices approximating cost or below and thus to undercut and ravage the less affluent competition."

suppliers of Consolidated to purchase from Gentry solely or principally in the hope of maintaining or enhancing their sales position with Consolidated.

However, we find substance in both of respondent's contentions concerning the details of the order of divestiture which should be issued. Respondent points out that its stock is publicly held by thousands of investors. Their simultaneous ownership of Gentry and Consolidated shares is not likely to have an adverse effect on competition. An order prohibiting transfer of stock in a new, independent, reconstituted Gentry corporation to officers, directors, executive employees, and major shareholders (*e.g.*, owners of more than 2% of the stock) of Consolidated might therefore suffice. Further, a six-month deadline for divestiture of Gentry's entire business may be unnecessarily abrupt. However, on these and other aspects of the proposed order we are without adequate information at this time to determine what would be the most appropriate and effective provisions to be included.

In addition, we are of the opinion that the hearing examiner's order is, in one important respect, inadequate and incomplete. Since respondent has admittedly engaged in a practice which we have found to be an unfair method of competition, protection of the public interest requires that it be specifically ordered to desist from any future resumption of that practice. Cases such as *Waugh Equipment Co.* and *Mechanical Manufacturing Co.*, Part IV, *supra*, show that anti-competitive reciprocity relationships between firms may be established not only through a clear-cut, parent-subsidiary connection but also through ownership or control of one company by important officials of another. For this reason, no relief will be adequate unless it prohibits Consolidated and Gentry

from having common officers, directors, and executive employees and precludes stock ownership in each firm by officers, directors, and executive employees of the other.

Preparation of a sound and equitable order embodying these provisions requires that the matter be explored more fully by the Commission and the parties than has yet been done here. The controversy up to now has centered on the issue of violation. Now that it has been determined that Section 7 has been violated, we believe it would be useful and desirable to follow a procedure here analogous to that provided in Rule 4.22(c). Within twenty days after service of this decision, counsel supporting the complaint shall file with the Commission a proposed form of order appropriate to our decision, together with a supporting memorandum. Counsel for respondent may, within twenty days thereafter, file an alternative form of order, together with a supporting memorandum; and counsel supporting the complaint may, within ten days thereafter, file a statement in reply thereto. The Commission will, upon consideration of the materials submitted, enter its final order.

Commissioner Anderson dissented to the decision in this matter and Commissioner Higginbotham did not participate.

NOVEMBER 15, 1962

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